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IN THE

Supreme Court of the United States

OCTOBER TERM, 1970

No. [redacted]

[redacted]

v.

[redacted]

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE [redacted] CIRCUIT

[redacted]

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1949

No. .....

PRUDENCE-BONDS CORPORATION (New Corporation),
Petitioner,

v.

SAMUEL SILBIGER, et al.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

To the Honorable, the Chief Justice of the United States and the Associate Justices of the Supreme Court of the United States:

Petitioner, Prudence-Bonds Corporation (New Corporation), respectfully prays that a writ of certiorari issue to review the decree of the United States Court of Appeals for the Second Circuit entered in the above cause on March 7, 1950, modifying an allowance awarded to Samuel Silbiger, Esq., and affirming allowances awarded to Arthur Miller, Esq. and Weil, Gotshal & Manges, Esqs. for services in the proceeding for reorganization of Prudence-Bonds Corporation, Debtor, under Section 77B of the Bankruptcy Act (R. 755, 765). Petitioner's appeal to the Court below was taken by leave of the Court and "limited to the question of conflict of interest represented" (R. 7).

Opinion Below

The opinion of the Court of Appeals for the Second Circuit dated March 7, 1950 (R. 755) is not yet reported.

Jurisdiction

The decree of the Court of Appeals, Second Circuit, was entered on March 7, 1950 (R. 765). Petitions for rehearing filed in that Court by petitioner (R. 766) and by Samuel Silbiger. Esq. (R. 779) were denied on April 5, 1950 (R. 786), although the Court, on the said petition of petitioner, amended its opinion (R. 785).

The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended, 28 U. S. C. 347(a), and Section 24(c) of the Bankruptcy Act, as amended, 11 U. S. C. Sec. 47(c).

Questions Presented

In a corporate reorganization under the Bankruptcy Act, a proceeding (called for convenience the "Construction Proceeding") was had to construe a confirmed Plan of Reorganization, and involved, in part, a controversy over priorities among two classes of bondholders, one class being called "Surplus Series", the other "Deficit Series". Two differing situations necessitate division of the questions into two categories.

I

Samuel Silbiger, Esq., an attorney at law, represented bondholders of both Surplus and Deficit Series. Without consent of his clients or court authorization, Mr. Silbiger advocated in the Construction Proceeding the interests of his Surplus Series clients and opposed the interests of his

Deficit Series clients. The Surplus Series won the controversy on an appeal prosecuted by Mr. Silbiger and others. Mr. Silbiger was awarded an allowance of $75,000 payable by the Surplus Series. On appeal by petitioner and Reconstruction Finance Corporation, the Court below held that Mr. Silbiger represented conflicting interests and was disloyal to one of the interests, but, confessing to a departure from the established "rule of undivided loyalty", which requires denial of all compensation to an attorney serving conflicting interests, held that he may nevertheless have an allowance on a reduced basis on the ground "there is a distinction between a corporate reorganization and an ordinary suit *inter partes*" (R. 760).

The questions presented regarding Mr. Silbiger are:

1. Is the "rule of undivided loyalty" applicable to attorneys at law with the same force and effect in a corporate reorganization proceeding under the Bankruptcy Act as it is in a suit *inter partes?*

2. In applying the "rule of undivided loyalty" can a valid distinction be made between a corporate reorganization proceeding under the Bankruptcy Act and a suit *inter partes* so as to authorize the bankruptcy court to award an allowance to an attorney serving conflicting interests, payable by the interest to whom he was loyal?

3. Is the decision of the Court below a valid exception to the "rule of undivided loyalty" as enunciated in decisions of this Court involving conflicts of interests in bankruptcy cases?

II

Arthur Miller, Esq. and Messrs. Weil, Gotshal & Manges appeared in the Construction Proceeding on behalf of individual clients who bought and sold during the proceeding many large blocks of bonds of both Surplus and Deficit Series. They advocated the side of the Surplus Series;

they did not purport to represent or owe any duty to other bondholders of any class; and they did not file the statement required by Section 210 of the Bankruptcy Act. The Court below affirmed allowances to them aggregating $30,000, payable by the Surplus Series.

The questions presented regarding these awards are:*

4. Does the Bankruptcy Act require denial of any allowance of compensation to attorneys whose clients, during the proceeding in respect of which the services were rendered, actively traded in the securities of the corporation in reorganization?

5. In a contest in a corporate reorganization over priorities among classes of security holders are the interests of individuals who actively trade in the securities of the different classes in conflict with the interests of the classes, and, if so, does the Bankruptcy Act require denial of allowances to attorneys who appear only for such individuals and disclaim any duty to any class?

Statute Involved

The pertinent provisions of the Bankruptcy Act, as amended, are set forth in the Appendix, infra, p. 22.

Statement

When the Debtor went into reorganization it had outstanding eighteen Series of bonds aggregating approxi-

* The Court below held that there might be a right of subrogation against the clients of Mr. Miller and Messrs. Weil, Gotshal & Manges, but that it could not determine such question for the reason the clients "are not parties to this proceeding and have not been heard" (R. 764). An additional question which will be urged in the argument on the merits is whether such right of subrogation is not determinable in the proceeding to fix allowances and enforceable by way of reduction of the allowances made.

mately $56,000,000 (R. 212). Each Series was secured by Trust Fund collateral under a Trust Agreement made by the Debtor to a Bank, as Trustee (R. 212). As each Series had separate collateral, some Series were better secured than others (R. 671-672). The bonds of all Series were guaranteed by The Prudence Company, Inc. which itself held $1,910,300 principal amount of the bonds, including some bonds of each Series (R. 212-213).

During the reorganization the Debtor was found to be insolvent (R. 213). The bonds held by the Guarantor were subordinated to the bonds of each Series in the hands of the public (R. 214). The Guarantor itself went into reorganization, was found to be insolvent and was succeeded, under a Plan of Reorganization, by a new corporation named Prudence Realization Corporation, which thereupon became the holder of the subordinated bonds (R. 212).

The Plan of Reorganization of Prudence-Bonds Corporation, consisting of a separate Plan for each bond Series and a General Plan, was confirmed in 1938; the separate Series Plans, except one, were all substantially the same (R. 215). The General Plan provided for a new corporation, also named Prudence-Bonds Corporation (petitioner here), to be owned by the bondholders; the separate Series Plans for an extension of the maturity of the bonds and changes in interest provisions (R. 119, 215). Eleven Banks had been Trustees of the bond Series (R. 120). Under the Plan, one Bank became Trustee of all Series under a Supplemental Trust Agreement with petitioner (R. 215). Upon confirmation, jurisdiction was reserved to carry out the Plan (R. 215).

As part of the proceedings to carry out the Plan, the bankruptcy court, among other things, authorized and directed the former Bank Trustees of the bond Series to account in the reorganization court for their acts as Trustees (R. 217). There then ensued extensive litigation relating to the accounts which has been the subject of sev-

eral decisions of the District Court, the Court of Appeals and several petitions for certiorari.*

The Construction Proceeding, in respect of which the instant allowances were awarded, was instituted in the fall of 1945, following collection of a large judgment against one of the accounting Bank Trustees (R. 121-122).† The questions in the proceeding arose in this way:

The Trust Funds of the Surplus Series had collateral sufficient to pay the principal of the publicly held bonds of the Series and leave an excess in principal account, but the excess was not sufficient to pay the arrears of interest at the original bond rate (R. 562-564, 665). The Trust Funds of the Deficit Series (which constitute the majority of the 18 Series) are insufficient to pay the principal of the publicly held bonds (R. 665). The Plan provided that interest on the bonds was payable at the rate of 5½%, but only to the extent that income on the Trust Fund collateral would suffice, and, in substance, that no payments of principal or interest were to be made on the subordinated bonds until the publicly held bonds of the Series were paid in full (Prior record,‡ pp. 111-113, 164). The

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* *Central Hanover B. & T. Co.* v. *President and Directors of the Manhattan Co.*, 105 F. 2d 130; *Manufacturers Trust Co.* v. *Kelby*, 125 F. 2d 650, cert. denied, 316 U. S. 697; *Brooklyn Trust Co.* v. *Kelby*, 134 F. 2d 105, cert. denied, 319 U. S. 767; *President and Directors of the Manhattan Co.* v. *Kelby*, 57 F. Supp. 839, modified and affirmed, 147 F. 2d 465, cert. denied, 324 U. S. 866; *Eddy* v. *Kelsey*, 148 F. 2d 323; *In re Prudence-Bonds Corporation*, 76 F. Supp. 643; see also *Eddy* v. *Kelby*, 319 U. S. 755, and *Eddy* v. *Kelby*, 163 F. 2d 56, cert. denied, 332 U. S. 836, relating to allowances in the accounting proceedings.

† On the accountings in 15 of the 18 Series of bonds approximately $4,277,100 was recovered for the Trust Funds and allowances for services and expenses in connection therewith were heretofore awarded by the bankruptcy court (R. 227-228). The accountings in two Series are pending.

‡ "Prior record" refers to record on appeal in the Construction Proceeding, *Eddy* v. *Prudence-Bonds Corporation*, 165 F. 2d 157, cert. denied, 333 U. S. 845, which is an exhibit in the instant case, but was not printed since it is on file in the Court below and in this Court.

Plan further provided that upon retirement of all bonds of a Series all collateral remaining in the Trust Fund was distributable, when liquidated, *pro rata* among the other Series then outstanding (Prior record, p. 155; R. 222-223). The purpose of this latter provision was to "enable the less fortunate to be benefited from an excess of collateral of the better issues" (Prior record, pp. 261-262; R. 671-672).

The main question which arose in the Construction Proceeding was how collateral in principal account of a Series in excess of an amount sufficient to pay the principal of the publicly held bonds of the Series was distributable among the three classes of creditors having an interest therein; namely, 1) the publicly held bonds, 2) the subordinated bonds, and 3) the other Series of bonds.* This in turn raised the question: When were the publicly held bonds to be deemed paid in full? Were they paid in full upon payment of principal with income interest only, or were they entitled to unpaid interest at the original bond rate to the date of final payment of the principal and to have such arrears of interest paid out of the corpus of the Trust Funds before any payments could be made to subordinate lienors? †

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* In the Fifth and Ninth Series there was an additional creditor. The Bank, which was the former Trustee, obtained, on payment of the surcharge recovered against it, liens of $85,825 and $88,124.98 on the Fifth and Ninth Series Trust Funds, respectively, which were subordinated to all bonds of the respective Series, including the subordinated bonds (R. 228), and thus had priority over the above mentioned class 3 creditors, namely, the other Series of bonds. In addition, the judgment against the Bank provided that if the bonds of either the Fifth or Ninth Series were "paid in full", the Bank could apply "for relief by way of repayment to it of any surplus remaining in the Trust Fund" (R. 228).

† Certain subsidiary questions relating to adjustment of funds between principal and income accounts were also involved in the Construction Proceeding, but these questions became moot by the decision of the Court of Appeals on the main question (*Eddy* v. *Prudence-Bonds Corporation*, 165 F. 2d 157).

To obtain a judicial determination of the question of construction, petitioner and City Bank Farmers Trust Company, the new Trustee for all Series, petitioned the reorganization court for instructions (R. 228-229, 234-235, 236-237).

The issue was referred to a Special Master who reported, in substance, that the bonds were income bonds on which interest was payable only to the extent earned on the collateral (R. 131).

Under the Master's Report, collateral in Surplus Series was to be used, first, to pay the principal of the subordinated bonds of the Series, and the balance then remaining was distributable *pro rata* among the public bondholders of the Deficit Series, with the exception that in the Fifth and Ninth Series the above mentioned subordinate liens of the Bank were to be paid first out of collateral remaining after payment of the principal of the subordinated bonds of said Series respectively (R. 131). To illustrate, the Fifth Series is a Surplus Series. After payment of the principal of the Fifth Series bonds there remained $360,610.22, which, under the Master's Report, was payable, 1) $67,200 in full payment of subordinated Fifth Series bonds, 2) $85,825 in full payment of the Bank's subordinate lien, and 3) $207,585.22 to the public bondholders of the Deficit Series *pro rata* (R. 665).

In the aggregate, under the Special Master's Report, the public bondholders of the Deficit Series would have received approximately $810,000 from the Surplus Series (R. 665).

The Master's Report was confirmed by the District Court (R. 237-239), and on an appeal prosecuted by Mr. Silbiger and Messrs. Weil, Gotshal & Manges the order of the District Court was reversed (*Eddy* v. *Prudence-Bonds Corporation*, 165 F. 2d 157), certiorari was denied (333 U. S. 845) and the Construction Proceeding was concluded in July, 1948 (R. 243).

Under the reversing order of the Court of Appeals (165 F. 2d 157), collateral remaining in principal account of

a Surplus Series is distributable on account of arrears of interest on the bonds of the Series at the original bond rate, with the result that neither the subordinated bondholder nor the Bank (as holder of a subordinate lien in the case of the Fifth and Ninth Series only), nor the public bondholders of the Deficit Series will receive any distributive share from the Surplus Series.

In the reorganization, Mr. Silbiger represented George E. Eddy, Katherine Born and Bessie B. Reilly (R. 248-249, 365, 368, 369, 513-522, 533, 543, 573-575). Mr. Eddy holds $16,000 of bonds of ten Series, $4,000 of which are of Surplus Series and $12,000 of Deficit Series (R. 248-249, 575, 665). Mrs. Born and Mrs. Reilly hold a total of $14,000 of bonds of three Series, all of which are Deficit Series (R. 249, 573-574, 665). The result successfully advocated by Mr. Silbiger in the Construction Proceeding was adverse to the financial interests of Mrs. Born and Mrs. Reilly, and to the financial interests of Mr. Eddy as holder of $12,000 of Deficit Series bonds. Under the order of the District Court, which Mr. Silbiger aided in reversing, the Deficit Series in which Mr. Eddy holds bonds would have received approximately $624,500 from the Surplus Series, and the Deficit Series in which Mrs. Born and Mrs. Reilly hold bonds would have received approximately $155,200 (R. 222-223, 248-249, 573-574, 665).

For his services in the Construction Proceeding, which were not extensive,* and the result of which adversely

* The Construction Proceeding involved, in substance, only three short hearings before the Master, one contested motion before the District Court, a consolidated appeal, a petition for rehearing and a petition for certiorari (R. 244-245). All papers prepared by Mr. Silbiger in all courts, exclusive of his briefs, totaled only 49 pages (R. 146-147). In his brief on the appeal in the proceeding Mr. Silbiger stated, "In the case at bar no dispute as to any facts ever arose * * *. The only issues presented are issues of law, involving the interpretation of the plans * * *" (R. 288-289). And in his brief in this court in opposition to the petition for certiorari, Mr. Silbiger stated, "No controversy of public interest or importance with respect to legal principles is involved" (R. 289).

affected the financial interests of two of his three individual clients and may have adversely affected his third client,* Mr. Silbiger requested an allowance of $459,500;† he was awarded $75,000 (R. 10, 158), which sum is subject to reduction under the decision of the Court below (R. 761).‡

Mr. Miller and Messrs. Weil, Gotshal & Manges appeared in the Construction Proceeding on behalf of two groups of individual bondholders (R. 326, 328, 352-353, 544-545, 546, 553-554, 611, 622). During the pendency of the reorganization the clients of these attorneys traded in Prudence bonds on a large scale. Mr. Miller's clients purchased $447,300 of the bonds and sold $244,300 of bonds; the clients of Messrs. Weil, Gotshal & Manges purchased $537,100 of bonds and sold $439,000 of bonds (R. 153-156, 616, 666-669, 708-711, see also R. 306-315). As the Court below said, "Miller's clients always held and traded in more bonds of 'Surplus Series' than 'Deficit Series'; Weil, Gotshal & Manges' clients' dealings were more in bonds of 'Deficit Series'" (R. 761). These attorneys, notwithstanding their clients dealt in bonds of most all Series, confined their activities in the Construction Proceeding to the Fifth Series (R. 326, 357, 609, 611). They said they never inquired whether their clients held bonds of other Series (R. 547, 553); and claimed they first learned of such fact

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* Mr. Silbiger testified in the proceeding to fix his allowance that he did not know "how the results (of the Construction Proceeding) affected the financial interests of Mr. Eddy", and that he never "made the calculation whether he was better off one way or another" (R. 467).

† Petitioner contended that the allowance requested by Mr. Silbiger "was so exorbitant as to shock the conscience of a court of equity" and justify denial of any allowance (R. 113, 114).

‡ Mr. Silbiger applied for leave to appeal his award of $75,000 and his application was denied; he attempted to appeal as of right and his appeal was dismissed. He then petitioned for certiorari to review the orders of the Court below and his petition was denied on April 24, 1950 (*Silbiger* v. *Prudence-Bonds Corporation*, No. 546, October Term, 1949).

when petitioner proved it at the hearings on the allowance applications (R. 553, 570-571).* They advocated in the Construction Proceeding the side of the Surplus Series. Mr. Miller, however, did not appeal and took no part in the appeal (R. 183-184, 263, 268, 331-332). Messrs. Weil, Gotshal & Manges applied for an allowance of $50,000 and were awarded $20,000; Mr. Miller applied for $16,500 and was awarded $10,000 (R. 10, 158). Their awards were affirmed by the Court below (R. 761).

The allowance applications were first passed upon by a Special Master, whose Report was modified by increasing by $5,000 the allowance to Messrs. Weil, Gotshal & Manges and as so modified confirmed (R. 10, 157, 318). Petitioner and Reconstruction Finance Corporation filed objections to the applications (R. 112, 148), and objections to the Master's Report (R. 189, 205, 276). Petitioner and RFC sought leave to appeal on several grounds (R. 13) and their application was granted limited to the questions of conflicts of interests (R. 7).

Specification of Errors to Be Urged

The Court below erred:

1. In holding that Samuel Silbiger, Esq. may be awarded an allowance notwithstanding its finding that he served two conflicting interests and opposed and was disloyal to one of the interests he represented.

2. In holding that a particular exception may be made to the "rule of undivided loyalty" in a case of an attorney who serves conflicting interests in a corporate reorganization under the Bankruptcy Act.

3. In holding that the "rule of undivided loyalty" has less force in a corporate reorganization under the Bankruptcy Act than it has in a suit *inter partes*.

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* They would have learned about their clients' holdings and dealings in the bonds if they had complied with Section 210 of the Bankruptcy Act.

4. In failing to hold that Mr. Silbiger should be denied any allowance.

5. In holding with regard to Mr. Miller and Messrs. Weil, Gotshal & Manges that the Bankruptcy Act authorizes the granting of an allowance to attorneys serving only the individual interests of speculators in the bonds of the corporation in reorganization.

6. In holding that the clients of Mr. Miller and Messrs. Weil, Gotshal & Manges are not parties to the instant proceeding to fix allowances, and in failing to hold that any right of subrogation against the said clients could be enforced by way of reduction of the allowances awarded to the said attorneys.

7. In failing to hold that Mr. Miller and Messrs. Weil, Gotshal & Manges should be denied any allowance.

Reasons for Granting the Writ

1. The decision of the Court below presents important questions of law involving the administration of the Bankruptcy Act and the obligations of an attorney to his clients in corporate reorganization cases.

2. The decision below with regard to Mr. Silbiger:

(a) Is a departure from established doctrine and is probably in substantial conflict with decisions of this Court and of other appellate courts, both State and Federal.

(b) The Court below determined that Mr. Silbiger represented conflicting interests and was disloyal to one of the interests and that he "must be denied any allowance whatever, unless there is a distinction between a corporate reorganization and an ordinary suit *inter partes*" (R. 760). The Court held there was such a distinction and that the penalty of Mr. Silbiger's disloyalty should be a

reduction of his allowance, rather than a denial of any allowance. The Court then said (R. 761):

> "* * * How far the penalty should be mitigated, we leave to the district court * * *. We will, however, say now—all the issues having been argued—that we should regard it as an abuse of discretion not to cut the allowance by at least one-third. * * * We do not wish to indicate that we think a cut of one-third is enough, * * *."

There is no yardstick to measure in dollars the amount by which an allowance should be reduced in a case of disloyalty of an attorney to a client; the suggested cut of at least one-third appears to be speculative and arbitrary. "Such a calculation of probabilities is beyond the science of the chancery" (Cardozo, C. J., in *Meinhard* v. *Salmon*, 249 N. Y. 458, 465). The Deficit Series clients whom Mr. Silbiger opposed and to whom he was disloyal would have received in excess of $667,000 under the order of the District Court in the Construction Proceeding which Mr. Silbiger appealed and aided in reversing on behalf of his Surplus Series clients. This Court, in *Woods* v. *City National Bank*, 312 U. S. 262, 268, said: "the incidence of a particular conflict of interest can seldom be measured" and the "bankruptcy court need not speculate" as to the effect or result of the conflict. This Court also said in the *Woods* case (p. 268), citing *American United Mutual Life Ins. Co.* v. *City of Avon Park*, 311 U. S. 138: "'reasonable compensation for services rendered' necessarily implies loyal and disinterested service in the interest of those for whom the claimant purported to act".

(c) The Court below, in holding that Mr. Silbiger may have an allowance, stated (R. 759-760):

> "* * * Certainly by the beginning of the Seventeenth Century it had become a common-place that an attorney must not represent opposed interests; and the usual consequence has been that he is debarred from receiving any fee from either, no matter how successful his labors * * *."

And then concluded by saying (R. 761):

> "* * * we recognize that we are departing from a doctrine that has been applied with great severity."

In departing from established doctrine, the Court below failed to follow the decision of this Court in the *Woods* case, *supra,* which requires "strict adherence" to the doctrine, particularly in corporate reorganization cases. In the *Woods* case, this Court cited and relied upon *Meinhard* v. *Salmon,* 249 N. Y. 458, 464, where Mr. Justice Cardozo (then Chief Judge) made his classic statement on the attitude of courts of equity when petitioned "to undermine the rule of undivided loyalty by the 'disintegrating erosion' of particular exceptions" and said the rule "will not consciously be lowered by any judgment of this Court".

Both this Court and the New York Court of Appeals recognized that one "particular exception" leads to another, and a seemingly good one usually to a bad one. The "particular exception" made by the Court below is that the rule is not applicable with full force in cases of lawyers who serve conflicting interests in corporate reorganizations under the Bankruptcy Act (R. 760).

The dangers inherent in making exceptions to the "rule of undivided loyalty" are indicated by the speculations indulged in to make the instant exception. The basis for the exception was that Mr. Silbiger's Deficit Series clients were represented in the Construction Proceeding by petitioner, Prudence-Bonds Corporation (R. 760); the inference being that they were, therefore, adequately represented and only partially injured by Mr. Silbiger's disloyalty. On the petition for rehearing, however, the pillar on which the exception stood fell; the Court below admitted it made a mistake of fact in saying that the Deficit Series were represented by petitioner, Prudence-Bonds Corporation (R. 785).* The Court then made a second choice. It

* Petitioner Prudence-Bonds Corporation represents all eighteen Series of bonds and at each stage of the Construction Proceeding made it clear that it could not and should not advocate for one group of its bondholders in opposition to the other (R. 775-778).

said the public bondholders of the Deficit Series were represented by Prudence Realization Corporation, the successor to the defaulting Guarantor and holder of the subordinated bonds of both Surplus and Deficit Series (R. 785, 212-213), and that if Mr. Silbiger had applied to the Court "to be freed of his duties to" the Deficit Series "it is at least doubtful whether * * * the judge would have thought it necessary that an attorney should be appointed in addition to him who represented the Prudence Realization Corporation" (R. 785). It is on this that the exception now stands.

If Mr. Silbiger had made such an application it is doubtful that the Judge would have granted it without appropriate consents of the three individuals who retained Mr. Silbiger and made it possible for him to be in the case. It is doubtful that the Judge would have granted it at all. If all facts had been brought out, the application might very well have been viewed with suspicion. Mr. Silbiger would have been seeking court authorization to advocate for a result which would adversely affect the financial interests of two of his individual clients and might adversely affect the financial interests of his third client.* Upon abandonment by Mr. Silbiger of the three bondholder clients through whom he derived a right to represent bondholders as a class, Mr. Silbiger would have been left without any client and would have had no standing to continue in the proceeding.

There is also substantial doubt whether the District Court Judge would have considered the public bondholders of the Deficit Series adequately represented by counsel for the subordinated bondholder. It is true that if the subordinated bondholder had succeeded in the posi-

* Mr. Silbiger's clients Mrs. Born and Mrs. Reilly held $14,000 of bonds all of Deficit Series, and of the $16,000 of bonds held by his client Mr. Eddy, $12,000 were of Deficit Series (R. 248-249, 573-575, 665). In the proceeding to fix allowances, Mr. Silbiger admitted Mr. Eddy may have lost money as a result of the contentions he advocated in the Construction Proceeding (R. 469).

tion it took in the Construction Proceeding the public bondholders of the Deficit Series would have benefited. But it is true also that the subordinated bondholder did not speak for and was not authorized to speak for the Deficit Series public bondholders. The result was that the appeal in the Construction Proceeding was briefed as if it presented only a contest between the public bondholders of *all* Series on one side and the subordinated bondholder (the defaulting Guarantor) on the other (R. 594). And it may have been decided on such an erroneous assumption. The Court below, by the three Judges who decided the instant appeal, said in their opinion on the Construction Proceeding appeal "We sustain the position of the Publicly Held Bonds", whereas, actually their decision was against all Deficit Series public bondholders who constitute the majority of all public bondholders (*Eddy* v. *Prudence-Bonds Corporation,* 165 F. 2d 157, 159, cert. denied, 333 U. S. 845). Then for the first time the subordinated bondholder undertook to speak for the Deficit Series public bondholders. It petitioned for rehearing and certiorari and urged that the Court had "Mistakenly assumed the controversy was between the Publicly-Held Bonds on the one side, and the Guarantor on the other" (R. 594-595). Its efforts at that point to aid itself by mentioning the rights of the Deficit Series public bondholders were futile and came much too late to be considered as constituting adequate representation of the Deficit Series.

The tenuous theory of the exception is, therefore, that if counsel for another party had won his case he would have incidentally won the case for the clients to whom Mr. Silbiger was disloyal. The theory is entirely speculative, it is wholly contrary to the basic reasons for the "rule of undivided loyalty". It would not be too great an extension to say that an attorney for two opposed parties in a litigation might have compensation from the winner to whom he adhered for the reason that the losing party, if he had been represented, would have lost the case anyway. Or to say that a broker guilty of disloyalty might neverthe-

less have his commission for the reason he obtained the best bargain for both buyer and seller. Or that a trustee, although disloyal, made a good bargain for his beneficiary.

All these and similar theories, however, have many times been rejected by the Courts when petitioned "to undermine the rule of undivided loyalty". The rule is grounded in broad principles of public policy, applicable with equal, if not more, force in corporate reorganizations where lawyers appear on behalf of classes composed of large numbers of security holders, most of whom have no contact with the lawyer (Cf. *Weil* v. *Neary*, 278 U. S. 160, 171). "The rule is indeed scrupulous and rigid" (*Presbyterian Church* v. *Plainfield Trust Co.*, 139 N. J. Eq. 501, 513). "The 'law does not stop to inquire whether the contract or transaction was fair or unfair. It stops the inquiry when the relation is disclosed * * * without undertaking to deal with the question of abstract justice in the particular case'" (*Wendt* v. *Fisher*, 243 N. Y. 439, 443-444); "It prevents frauds by making them as far as may be impossible knowing that real motives often elude the most searching inquiry * * *. The value of the rule * * * lies to a great extent in its stubbornness and inflexibility" (*Munson et al.* v. *S. G. & C. R. R. Co.*, 103 N. Y. 58, 74). "The rule is designed to obliterate all divided loyalties which may creep into a fiduciary relationship and utterly to destroy their effect * * *" (*City Bank Farmers Trust Co.* v. *Cannon*, 291 N. Y. 125, 132).

(d) In lowering the "rule of undivided loyalty" and creating the instant "particular exception", the Court below followed its recent decision in *Berner* v. *Equitable Office Building*, 175 F. 2d 218 (R. 761), where it held that Berner might have an allowance on a reduced basis, notwithstanding a possible violation of Section 249 of the Bankruptcy Act by reason of Berner's activities in giving inside information to relatives who dealt in the stock of the company in reorganization. In the *Berner* case, in which the opinion of the Court was also by Judge Learned

Hand, the decision of this Court in the *Woods* case *supra*, was cited, but only in respect of a collateral question of burden of proof (175 F. 2d 220). The decision of the Court below in the instant case does not mention the *Woods* case, which is a corporate reorganization case.

The *Berner* case itself is probably in substantial conflict with the decision of the Third Circuit in *In re Midland United Co.*, 159 F. 2d 340, where the Court held that dealings in securities by the wife of a fiduciary will bar the fiduciary from receiving any compensation. In the *Berner* case, the Court, citing *In re Midland United Co.*, said (p. 221): "indeed, in some jurisdictions a purchase by a trustee's wife is *ipso facto* invalid".

The *Berner* case appears to be another "particular exception" made in disregard of the rule of the *Woods* case.* The instant exception is a substantial extension of the exception in the *Berner* case. In the instant case, the Court said that the loss of all compensation required by a violation of Section 249 of the Bankruptcy Act "is a far milder consequence than attends the breach of full-fledged fiduciary duties" (R. 764), but inconsistently held that although Mr. Silbiger breached the "high trust" relationship of attorney and client, the consequence should be merely a reduction of his allowance which is "far milder" than the consequence of a breach of Section 249.

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* In the *Berner* case, the Court below said "in any event the reduction (of Berner's allowance) may well be not less than the loss to the sellers of whom Bell bought the 20,000 shares" (175 F. 2d 222). After remand, the District Court made various calculations and then decided that Mr. Berner "should be awarded, in the absence of the Peter Bell episode, a fee of $100,000. For the part he played in that transaction it is my judgment he should be assessed a minimum of $30,000. If it be said that this amount is in excess of the sum that the loss which the Commission (SEC) estimated may have come to persons who supplied stock to Bell, the reply must be that the difference between $30,000 and $24,643.40, or $5,356.60, is far less I believe than was the cost to this estate of the litigation that grew out of the stock purchase that was made by Peter Bell. * * * When all is said and done, one fact is as plain as day and that is that petitioner (Berner) wrongfully enabled Peter Bell to make a possible profit of $24,643.40". (*In re Equitable Office Bldg. Corp.*, Opinion by Judge Knox, Jan. 10, 1950, not officially reported.)

Thus, in recent months the "particular exception" of the *Berner* case has influenced the same Court to make this still greater "particular exception" and both exceptions have been made in disregard of decisions of this Court and of the weight of authority. The soundness of the "rule of undivided loyalty" is beyond question; the principle that "no man shall serve two masters" has been considered a good one for over 1900 years. It has particular force to the relationship of attorney and client; it should have special force in bankruptcy cases. As Mr. Justice Brewer (then Circuit Judge) said in *United States* v. *Costen,* 38 Fed. 24:

> "Now it is to the glory of our profession that its fidelity to its client can be depended on; * * * I can tolerate many things a lawyer may do * * *, but I cannot tolerate for a moment, neither can the profession, neither can the community, any disloyalty on the part of a lawyer to his client."

(e) The conscious lowering of the rule and the creating of "particular exceptions" thereto by the Second Circuit Court of Appeals will tend to further erosion of the rule's solid foundation by virtue of the substantial influence of decisions of the learned Court below upon Federal District Courts and other Courts of Appeals. In this situation, this Court should exercise its power of supervision to maintain the vitality of its decisions and the integrity of a doctrine so sound, so deeply ingrained in the law, as to make departure therefrom intolerable to courts, the profession and the community.

3. The decision below with regard to Mr. Miller and Messrs. Weil, Gotshal & Manges also raises substantial questions of interpretation and administration of the Bankruptcy Act. These questions, we believe, have not been, but should be, decided by this Court.

(a) These attorneys acted solely for individual clients who bought and sold during the Construction Proceeding, in which they rendered their services, large blocks of the Debtor's bonds of both Surplus and Deficit Series classes;

they did not represent or purport to represent or owe any duty to either class. The interests of their clients were of a competing and shifting character, changing from time to time as they bought and sold bonds. The Bankruptcy Act, we submit, was not intended to authorize classes of security holders to be charged with the fees of attorneys employed to represent the individual interests of speculators in the securities in reorganization.

(b) The awards of allowances to Mr. Miller and Messrs. Weil, Gotshal & Manges do violence to and impair the effectiveness of the spirit and purpose, if not the letter of, Section 249 of the Bankruptcy Act. True these attorneys did not themselves trade in the bonds. The fact, however, that their clients did—and on a large scale—results in a situation where the attorneys' primary duty and loyalty was to clients whose interests were necessarily in conflict with the interests of the class which is to pay the awards. The underlying basis of Section 249, which denies all compensation to representatives of security holders who deal in the securities of the company in reorganization, "means neither more nor less than that a fiduciary may not serve conflicting interests" (*In re Midland United Co.*, 64 F. Supp. 399, 415, aff'd 159 F. 2d 340). If the clients of these attorneys had paid their fees and were now applying for reimbursement, Section 249 would require denial of their applications (*Young* v. *Potts*, 161 F. 2d 597, 600). The same rule should be applied to direct applications of their attorneys so as to place the burden of their compensation on the clients where it belongs. "The principle that a client should pay for services rendered applies in proceedings under Section 77B as well as in other fields of litigation" (*Teasdale* v. *Sefton Nat. Fibre Can Co.*, 85 F. 2d 379, 382).

(c) Implicit in the decisions of this Court in *Dickinson Industrial Site, Inc.* v. *Cowan*, 309 U. S. 382; *Brown* v. *Gerdes*, 321 U. S. 178; *Young* v. *Higbee Co.*, 324 U. S. 204, is the proposition that allowances should not be awarded payable by a class to those who serve individual interests and who are not bound to the class by fiduciary ties. It

is certainly implicit in these decisions that allowances should not be made payable by a class to attorneys who serve individual interests in conflict with the interests of the class. The equitable principle of charging allowances to a class goes back to the early case of *Trustees* v. *Greenough,* 105 U. S. 527, in which the suit was instituted for the benefit of all creditors and in which this Court said (p. 532), "if the complainant is not a trustee, he has at least acted the part of a trustee in relation to the common interest". Mr. Miller and Messrs. Weil, Gotshal & Manges represented and purported to represent only their clients, and while disclaiming any duty to the class, and notwithstanding that they did not act "the part of a trustee in relation to the common interest", claim their fee from the class. They indeed were driven to disclaim a duty to the class in avoidance of the consequence of serving conflicting interests, since the interests of their clients and those of the class were not the same. To grant allowances in such circumstances would tend to impair the effectiveness of Section 249. Individuals could appear in reorganizations, state at the outset they appear only for themselves, deal in the securities to their own advantage, and the attorneys for such individuals, and the individuals as well, could obtain allowances. Section 249 is not the "only arrow in the quiver of the bankruptcy court"; it "was intended to augment and not to limit the jurisdiction of the Bankruptcy court" (*In re Midland United Co., supra,* 159 F. 2d 344, 345).

CONCLUSION

Wherefore, it is respectfully submitted that this petition for certiorari should be granted.

Respectfully submitted,

CHARLES M. MCCARTY,
Counsel for Petitioner.

April 27, 1950.

APPENDIX

Bankruptcy Act, Sec. 210, 11 U. S. C. Sec. 610: An attorney for creditors or stockholders shall not be heard unless he has first filed with the court a statement setting forth the names and addresses of such creditors or stockholders, the nature and amounts of their claims or stock, and the time of acquisition thereof, except as to claims or stock alleged to have been acquired more than one year prior to the filing of the petition.

Bankruptcy Act, Sec. 249, 11 U. S. C. Sec. 649. Any persons seeking compensation for services rendered or reimbursement for costs and expenses incurred in a proceeding under this chapter shall file with the court a statement under oath showing the claims against, or stock of, the debtor, if any, in which a beneficial interest, direct or indirect, has been acquired or transferred by him or for his account, after the commencement of such proceeding. No compensation or reimbursement shall be allowed to any committee or attorney, or other person acting in the proceeding in a representative or fiduciary capacity, who at any time after assuming to act in such capacity has purchased or sold such claims or stock, or by whom or for whose account such claims or stock have, without the prior consent or subsequent approval of the judge, been otherwise acquired or transferred.

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In the Supreme Court of the United States

OCTOBER TERM, 1949

No. 785

PRUDENCE-BONDS CORPORATION (NEW CORPORATION), PETITIONER

v.

SAMUEL SILBIGER, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

MEMORANDUM IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

This memorandum is submitted on behalf of the Reconstruction Finance Corporation, as an intervening party, and the Securities and Exchange Commission, as *amicus curiae*. Both of these agencies share identical views with regard to one of the principal questions in this case, namely, whether in a corporate reorganization an attorney who represents conflicting interests is barred from receiving

any fee from the estate, no matter how successful his labors.[1]

The court below has squarely held that an exception to the general rule barring compensation to an attorney who represents conflicting interests should be made in the case of corporate reorganizations, and that the bankruptcy court instead may diminish the fee otherwise payable by the estate which benefited from the services by taking into account the character of the conflicting representation. The opinion of the court below (R. 755) is reported at 180 F. 2d 917.

We submit that the decision below is erroneous; that it is in conflict with the decisions of this Court and of the Court of Appeals for the Third Circuit; and that the question is of such importance as to warrant certiorari. The relevant statutory provisions are Section 206 of the Bankruptcy Act (11 U.S.C. 606) and Section 243 (11 U.S.C. 643), which are set forth in the Appendix, *infra*, p. 13.

The essential facts can be briefly stated. Sometime in 1934, Silbiger was employed by George E. Eddy, Mrs. Katherine Born and Mrs. Bessie B.

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[1] This is the question presented by the Silbiger allowance involved in No. 785. Silbiger has filed a cross-petition for certiorari. *Silbiger* v. *Prudence-Bonds Corporation (New Corporation) and Reconstruction Finance Corporation*, No. 829. There is a second question in No. 785, whether the allowances to Miller and to Weil, Gotshal and Manges are barred because their clients traded in securities of the debtor (Pet. 19-21). While we think the opinion of the court below goes too far in suggesting that attorneys' allowances are not at all affected by their clients' trading activities, we express no opinion as to the necessity for review of this second question.

Reilly, each of whom held a number of bonds in different series issued by the debtor, to represent them in the reorganization proceedings of the Prudence-Bonds Corporation under Section 77(b) of the Bankruptcy Act. Up to 1945, Silbiger represented the common interest of each of these clients in phases of the reorganization proceeding which led to the confirmation of a plan of reorganization in 1938, and in supplemental proceedings involving an accounting by the indenture trustees.[2] Silbiger was compensated from the estate for these services, receiving a total of $70,000 (R. 210).

In 1945, however, a proceeding arose to construe certain provisions of the reorganization plan in order to determine the relative rights of the various series of bonds to the collateral securing the bonds. At this point, the interests of the different series were opposed to each other. There were 18 different series of bonds outstanding, each backed by a separate block of collateral (R. 212). In some instances, the collateral was more than enough to meet the principal amount of the bonds that it secured, and the question in the construction pro-

[2] *Central Hanover B. & T. Co.* v. *President and Directors of the Manhattan Co.*, 105 F. 2d 130; *Manufacturers Trust Co.* v. *Kelby*, 125 F. 2d 650, certiorari denied, 316 U.S. 697; *Brooklyn Trust Co.* v. *Kelby*, 134 F. 2d 105, certiorari denied, 319 U.S. 767; *In re Prudence Bonds Corp.*, 57 F. Supp. 839, modified and affirmed, 147 F. 2d 465, certiorari denied, 324 U.S. 866; *Eddy* v. *Kelsey*, 148 F. 2d 323; *In re Prudence-Bonds Corporation*, 76 F. Supp. 643; see also *Eddy* v. *Kelby*, certiorari denied, 319 U.S. 755, and *Eddy* v. *Kelby*, 163 F. 2d 56, certiorari denied, 332 U.S. 836, relating to allowances in the accounting proceedings.

ceedings was whether the excess over that amount should be applied against the interest owing on these bonds or should go to certain other claimants, including holders of series of bonds without sufficient collateral to meet even the face amount (R. 131). For convenience, the series of bonds having collateral in excess of their principal amounts have been described as surplus series and the others as deficit series.

Silbiger's clients held primarily deficit series bonds. All of the bonds held by Mrs. Born and Mrs. Reilly were in that category, while Eddy held some bonds of the deficit series and some of the surplus series (R. 248-249). Notwithstanding the fact that the financial interests of some of his clients lay completely on the side of the deficit series, Silbiger took the position in the construction proceedings that the excess collateral behind the surplus series should go entirely to the holders of surplus series bonds to apply on their interest claims (R. 32). Silbiger and others successfully prosecuted an appeal from a contrary holding of the master and the district court.[3] In consequence of these efforts, excess collateral that would otherwise have been turned over to Silbiger's clients holding deficit series bonds was ordered to be paid instead to the holders of the surplus series bonds. For his serv-

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[3] *Eddy* v. *Prudence Bonds Corp.*, 165 F. 2d 157. The master and the district court had held that the excess collateral should be applied first to pay certain subordinated debt, with the remainder going to the deficit series.

ices in the contest among the various classes of bondholders in these construction proceedings, the district court awarded Silbiger a fee of $75,000 (R. 10).

On appeal from this award by the New Corporation and the Reconstruction Finance Corporation, the court below found that, even taking Silbiger's version of the facts as true, Silbiger had not properly severed his connection with the deficit series clients, that he continued in the fiduciary relationship of attorney not only to his particular clients but to all other holders of bonds in the deficit series; and that he was therefore serving conflicting interests (R. 757-759). The attorney, not the client, it held, has the responsibility for ascertaining and avoiding any representation of conflicting interests.

The court below conceded that if this were "an ordinary suit *inter partes*" the rule would apply that an attorney who represents opposing interests is debarred from receiving any fee from either, no matter how successful his labors; and that Silbiger would not be permitted to show whether the conflict of his loyalties had in fact influenced his conduct and, if so, to what extent (R. 760). However, the court decided that an exception from this rule should be made in a corporate reorganization where it can be shown that the evil of conflicting representation is mitigated because "the client [prejudiced by the attorney's divided allegiance] is other-

wise adequately protected, and the attorney is not paid in any part by the party whose side he has opposed" (R. 760). Finding these conditions present in the case at bar, despite the representation of conflicting interests, the court directed that Silbiger be allowed a fee provided it was reduced by at least one third of the amount awarded by the district court (R. 761).

The decision of the court below, allowing a fee to an attorney who represented conflicting interests in a corporate reorganization, is in direct conflict with *Woods* v. *City Bank Co.*, 312 U. S. 262, where this Court, refusing to inquire whether the representation of conflicting interests was in fact prejudicial to either client, denied compensation to attorneys and other fiduciaries who represented the conflicting interests of the mortgagee and equity owners in a Chapter X reorganization proceeding. The *Woods* decision was approved in *Brown* v. *Gerdes*, 321 U. S. 178, 182; it was followed by the Third Circuit in *In re Midland United Co.*, 159 F. 2d 340. See also *In re Ritz Carlton Restaurant & Hotel Co.*, 60 F. Supp. 861, 866-867 (D. N.J.). In making an exception to the strict requirement of "loyal and disinterested service" by fiduciaries as a condition to their compensation, the court below has undermined a fundamental policy of bankruptcy proceedings established by this Court not only in the *Woods* case but in *American United Mutual Life Insurance Co.* v. *City of Avon Park*, 311 U. S. 138; *Weil* v. *Neary*, 278 U. S. 160, 173;

and *Young* v. *Higbee Co.*, 324 U. S. 204. See also *Young* v. *Potts*, 161 F. 2d 597 (C.A. 6).[4]

No basis for an exception is found either in the language or the policy of the Bankruptcy Act. Section 243 of the Act (Appendix, *infra*, p. 13) authorizes the allowance of "reasonable compensation for services rendered"; and this phrase "necessarily implies loyal and disinterested service," *Woods* v. *City Bank Co.*, 312 U. S. at 268. The purpose of Section 206 of the Act (11 U.S.C. 606, *infra*, p. 13), which gives individual security holders a right to participate through counsel directly in the proceedings, and Section 243, *supra*, which authorizes compensation to them and their representatives from the estate, is to assure individuals the right to be heard through representatives who do not serve conflicting interests.[5] The decision below frustrates this Congressional policy. In view of the fact that Section 206 permits any security holder to be represented in the proceedings, it is not difficult for an attorney so inclined to find a client he might nominally repre-

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[4] That the instant case is a 77B proceeding is of no significance. The allowances to attorneys in this case are governed by the provisions of Chapter X of the Chandler Act. *In re Prudence Bonds Corp.*, 122 F. 2d 258, 260. In any case, the rule requiring loyal and disinterested service in the interest of the persons whom the attorney purports to represent applies to 77B proceedings and to all other types of bankruptcy proceedings. *American Ins. Co.* v. *Avon Park, supra; Weil* v. *Neary, supra; In re Republic Gas Corp.*, 35 F. Supp. 300 (S.D. N.Y.).

[5] See Hearings on H. R. 6439 and H. R. 8046 (1938) before the Committee on the Judiciary, House of Representatives, 75th Cong., 1st sess., at pp. 163, 186.

sent in almost any case. If the law permits attorneys, as the proceeding progresses, to desert their clients and shift to whatever they think will be the winning side on each point of litigation, where their chances of a substantial fee might be better, the "interests of investors tend to become secondary; the interests of lawyers, primary."[6] We do not suggest that this evil is present in the case at bar, but the decision does encourage the "tendency to evil in other cases." *Weil* v. *Neary,* 278 U. S. 160, 173. Indeed, the nature of corporate reorganization proceedings is such that, rather than affording room for relaxing exceptions from the standards applicable to an *inter partes* relationship, it requires, as this Court has held, the application of the highest standards of fiduciary conduct. *Woods* v. *City Bank Co., supra; S.E.C.* v. *United States Realty Improvement Co.,* 310 U. S. 434, 455.[7]

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[6] See S.E.C. Report on the Study and Investigation of the Work, Activities, Personnel and Functions of Protective and Reorganization Committees, Part I, 236, *et seq.,* (1937), where it was pointed out that in the absence of judicial scrutiny over counsel fees this situation was apparently of frequent occurrence in reorganizations, since the reorganization afforded "counsel great opportunity for entrepreneurial activity." The impression gained was "that reorganizations are frequently designed for the benefit of lawyers."

[7] There is no reason why attorneys in corporate reorganizations should practice in a less exacting climate than corporate directors, *Munson et al.* v. *S. G. & C. R. R. Co., et al.,* 103 N.Y. 58; commercial joint adventurers, *Meinhard* v. *Salmon,* 249 N.Y. 458; testamentary trustees, *Presbyterian Church* v. *Plainfield Trust Co.,* 139 N.J. Eq. 501; real estate brokers, *Wendt* v. *Fischer,* 243 N.Y. 439; to list only a few of the different types of fiduciaries who have been held to strict standards.

Contrary to the theory of the court below, there is nothing about corporate reorganization proceedings that enables the court to measure the effect of conflicting representation by looking to see whether the prejudiced clients were otherwise adequately represented. In the case at bar, the court could not be sure exactly who was "otherwise adequately" representing the interests of the deficit series, nominally but not actually represented by Silbiger.[8] Its reliance upon the fact that Silbiger's fee comes out of the clients whom his services benefited, not those he abandoned, fails to take into account the fact that their attorney, arguing for the opposing side of the case, successfully appealed from a decision in their favor and the abandoned clients lost benefits out of which they might willingly have paid fees. Cf. *Young* v. *Higbee Co., supra; Young* v. *Potts, supra.* Indeed, the impossibility of measuring the effect of representation of conflicting interests, manifest in the case at bar, proves the wisdom of the rule that no

[8] The court below originally suggested that their interests had been represented by the "New Corporation" (R. 760) but on rehearing the court stated it made a mistake and suggested that their interests were represented by "Prudence Realization Corporation" (R. 785). However, Prudence Realization Corporation did not speak for the public holders of deficit series, but for the corporate subordinated bondholders whose interests happened to coincide on one aspect of the issue in the Construction Proceedings with the public bondholders of deficit series, who were directly represented by Silbiger. See Pet. pp. 15-16. It is accordingly doubtful whether, if Silbiger had disclosed his representation of conflicting interests, the district court would have permitted him to proceed to represent one and drop the other. In any event, *Weil* v. *Neary, supra,* holds that such speculation is inadmissible.

inquiry should be made into whether representation of conflicting interests in fact harmed either client to any degree, or whether it resulted in fraud or unfairness. *Woods* v. *City Bank Co.*, 312 U. S. at 268; *American United Mutual Life Insurance Co.* v. *City of Avon Park*, 311 U. S. 138, 147; *Weil* v. *Neary*, 278 U. S. 160, 173; see, *Munson* v. *S. G. & C. R. R. Co.*, 103 N. Y. 58, 74; *Wendt* v. *Fischer*, 243 N. Y. 439, 443-444; *Presbyterian Church* v. *Plainfield Trust Co.*, 139 N. J. Eq. 501, 513.[9]

The prior decision by the court below in *Berner* v. *Equitable Office Building Corp.*, 175 F. 2d 218, offers no aid to the decision in the case at bar. The *Berner* decision is plainly erroneous, if it is deemed to hold that the rule against representation of conflicting interests does not apply to corporate reorganizations,[10] or that the effects of such representation can be mitigated by the extent of the injuries suffered by either client.[11]

The question in this case is of great importance in the administration of the bankruptcy and cor-

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[9] The absolute prohibition of the rule also avoids any reflection upon the integrity of the attorney involved, who may violate the rule inadvertently "without the slightest moral blame or stigma." *In re Midland United Co.*, 64 F. Supp. 399, 406 (D. Del.).

[10] In *Cromwell* v. *Curtis*, 99 F. 2d 810, the Second Circuit appeared to hold that the rule did not apply to corporate reorganizations, but this decision was virtually overruled by the *Woods* decision. 50 Yale L. J. 1492, 1494-1495.

[11] The court in the *Berner* case treated the facts as involving not a case of representing conflicting interests, nor as one under Section 249 of the Bankruptcy Act, but as one involving a breach of fiduciary duty which did not completely bar compensation to the trustee, citing Restatement of Trusts, Sec. 243. See 63 Harv. L. Rev. 1056.

porate reorganization statutes. It is a major policy of Chapter X of the Chandler Act to make certain that representatives of a class of security holders are not subject to the influence of conflicting interests.[12] The enforcement of the rule barring an allowance to fiduciaries who represent conflicting interests in corporate reorganizations cannot safely be left to the clients directly involved. As the court below held, this is a professional responsibility of the attorneys that cannot be intrusted exclusively to the judgment of clients. The Reconstruction Finance Corporation, a party to the appeal below, has an interest in preventing a violation of this rule in the case at bar, since any allowances to the attorneys will come out of funds which might otherwise go to it.[13]

The Securities and Exchange Commission, al-

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[12] See footnote 5, *supra*.

[13] RFC has a participation as a creditor, of approximately 16% in the assets of Prudence Realization Corporation, successor to The Prudence Company, Inc., guarantor of the Debtor's bonds. Among said assets which are being liquidated solely for the benefit of the creditors of The Prudence Company, Inc., are unsubordinated or publicly held bonds in various Series of original principal amount of $396,500 (R. 672).

Prudence Realization Corporation also holds subordinated bonds in unpaid original principal amount of $1,873,000, including bonds of $105,700 original principal amount in the Ninth Series, which has been charged (R. 11) with $24,704.84, approximately 24% of the allowances awarded in the district court. Since the order of the district court, the publicly held bonds in the Ninth Series have been paid in full with interest at the original rates. Accordingly, any allowances payable from the Ninth Series will not be paid from money which would otherwise be paid on account of subordinated bonds in the Ninth Series held by Prudence Realization Corporation.

though not a party to the proceedings below, has an interest which extends beyond this particular case, for it is charged with seeing to it that the appropriate standards of equity and fiduciary responsibility prevail in corporate reorganizations. See Sections 172 and 208 of the Bankruptcy Act (11 U.S.C. 572, 608); *S. E. C.* v. *U. S. Realty Co.*, 310 U.S. 434, 458-460; *In re Ritz Carlton Restaurant & Hotel Co.*, 60 F. Supp. 861; *In re Midland United Co.*, 64 F. Supp. 399, 403.

A decision in the case at bar will necessarily be a guide to the disposition of similar problems in other corporate reorganizations. The decision below clouds the clear rule of the Court in the *Woods* case; hence, if unreviewed, even if not followed in other Circuits, it will create confusion as to the applicable rule to be followed by the courts in the Second Circuit, which have jurisdiction over many important bankruptcy reorganizations. Accordingly, because of the conflict of decisions presented, and because of the importance of the question involved, it is urged that the petition for certiorari be granted.

Respectfully submitted,

PHILIP B. PERLMAN,
Solicitor General.

JUNE 1950.

APPENDIX

Bankruptcy Act, 30 Stat. 544, as amended by the Act of June 22, 1938, 52 Stat. 883, 11 U.S.C. 606, 643:

Section 206:

> The debtor, the indenture trustees, and any creditor or stockholder of the debtor shall have the right to be heard on all matters arising in a proceeding under this chapter. The judge may, for cause shown, permit a labor union or employees' association, representative of employees of the debtor, to be heard on the economic soundness of the plan affecting the interests of the employees.

Section 243:

> The judge may allow reasonable compensation for services rendered and reimbursement for proper costs and expenses incurred by creditors and stockholders, and the attorneys for any of them, in connection with the submission by them of suggestions for a plan or of proposals in the form of plans, or in connection with objections by them to the confirmation of a plan, or in connection with the administration of the estate. In fixing any such allowances, the judge shall give consideration only to the services which contributed to the plan confirmed or to the refusal of confirmation of a plan, or which were beneficial in the administration of the estate, and to the proper costs and expenses incidental thereto.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1949

No. [redacted] 52

PRUDENCE-BONDS CORPORATION (New Corporation),

Petitioner,

—v.—

SAMUEL SILBIGER, *et al.*

BRIEF OF RESPONDENT ARTHUR MILLER IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

ARTHUR MILLER
Respondent, Pro Se

LESTER H. MARKS
Counsel for respondent, Arthur Miller
11 Park Place
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1949

No. 785

PRUDENCE-BONDS CORPORATION (New Corporation),

Petitioner,

—v.—

SAMUEL SILBIGER, *et al.*

BRIEF OF RESPONDENT ARTHUR MILLER IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

Opinions Below

The opinion of the Court of Appeals for the Second Circuit, dated March 7, 1950 (R. 755) is not yet reported. The opinion of the United States District Court for the Eastern District of New York, dated July 25, 1949 (R. 318) is not reported.

Jurisdiction

Petitioner invokes the jurisdiction of this Court pursuant to section 240(a) of the Judicial Code, as amended, 28 U. S. C. 347 (a) and section 24(c) of the Bankruptcy Act, as amended, 11 U. S. C. 47(c).

Statement

This respondent deems necessary a further statement of the case than that submitted by petitioner, both to correct inaccuracies and to furnish additional fact.

Although all of the awards to counsel which were made in this matter were directed to be paid out of the funds of Series AA, Fifth, Sixth, Eighth, Ninth, Twelfth, Seventeenth and Eighteenth of Prudence bonds, Mr. Miller appeared only in the construction proceeding pertaining to the Fifth Series and applied for an allowance only out of the funds thereof (R. 10, 11, 70). The Fifth Series proceeding, which involved substantial issues of law governing all of the series, was instituted by an order to show cause dated August 3, 1945, based on a petition verified August 2, 1945, and was returnable September 4, 1945. Mr. Miller's first appearance was by affidavit sworn to on August 31, 1945 (R. 122, 123, 622, 623).

The Special Master herein found on undisputed evidence that in the "construction proceeding" Mr. Miller was the first to contend that, in addition to payment of the principal amount of their bonds, the Fifth Series public bondholders were entitled to interest thereon at the 5½% rate to date of payment and that the collateral of the Fifth Series should be applied thereto before being applied to any of the subordinate purposes (R. 183, 268). The construction proceedings were lengthy and difficult. Mr. Miller's services, which were onerous and protracted, are mentioned by the Special Master in his report and findings and may be found in detail in Mr. Miller's direct testimony thereon (R. 183, 184, 267-270, 735-743).

The Special Master specifically found that Mr. Miller "performed his duties with fidelity and rendered legal services of the highest calibre" (R. 270).

The results accomplished by counsel for the public bondholders in the "construction proceedings" were substantial. As a result of their efforts $1,994,453.79 was preserved for the public bondholders in various series which, without their efforts, would have been diverted to others (R. 168, 169, 247). A great part of it would have passed to subordinate lienors other than public bondholders of other series. Using the figures given by petitioner itself in its brief in the Court of Appeals (page 16) we find that $173,949.98 would have been paid to Bank of Manhattan on its subordinate liens, $1,009,886.22 to Prudence Realization Corporation and $810,637.59 to bondholders in other series.

No claim is made here, nor was it made in the Court of Appeals, that any conflict of interest existed so far as Mr. Miller is personally concerned. It is not claimed that he personally bought or sold Prudence securities or that he personally had any interest in any way adverse to the interests of the Fifth Series public bondholders. Petitioner claims, however, that Mr. Miller's clients dealt actively in Prundence bonds (Pet. pp. 3, 4, 10, 11, 19-21) and for that reason his allowance should be forfeited.

In his affidavit of August 31, 1945, Mr. Miller specified the persons for whom he appeared (R. 611). At the hearing before the Special Master herein he added the names of two other persons (R. 553, 554). Petitioner would give the unwarranted impression that Mr. Miller's clients were a group or syndicate united in interest so far as their investments in the Prudence bonds were concerned. That impression finds no basis in the record. The record fails to show other than that each acted for himself or herself alone. Their only common characteristic was that Mr. Miller was their attorney.

Unquestionably, some of them did no buying or selling whatever (R. 155, 620, 621). One acquired bonds by inheri-

tance (R. 708-711). Others, in the regular course of their business as securities brokers bought and sold some of the bonds (R. 587, 613-618, 620). Thus viewed as the activities of individuals, the buying and selling complained of by petitioner take on an entirely different aspect.

On the basis of all the facts it is submitted that no grounds are shown for granting a writ of certiorari against respondent Miller.

Respondent's Contentions

The respondent Arthur Miller makes the following contentions:

1. With respect to his application for a counsel fee herein section 249 of the Bankruptcy Act imposes only a personal obligation upon the respondent. It does not preclude the allowance to him by reason of the activities of some of the individual clients for whom he appeared.

2. Even had his right to the award depended upon the activities of his clients, their conduct was not such as would bar a recovery.

3. Respondent's services aided in establishing a fund for the benefit of an entire class of bondholders and his right to compensation out of that fund is not forfeited by reason of the fact that he was retained by and appeared in the proceeding on behalf of individual bondholders. Actually, the public bondholders would have been entirely precluded from representing their class in the proceeding unless as individuals they could appear therein by counsel.

4. No question is presented as to Mr. Miller warranting a review by this Court.

Respondent's Argument

I

Section 249 of the Bankruptcy Act does not bar the allowance made herein to respondent Arthur Miller. Petitioner complains of the activities of some of Mr. Miller's *clients*. There is no claim that Mr. Miller *personally* bought or sold Prudence securities. It is also not claimed that Mr. Miller's clients bought or sold for his benefit or account. In fact it is not even claimed that he was aware of their transactions.

The provision with respect to forfeitures of allowances by reason of transactions in securities, it will be noted, clearly specifies the separate and distinct classes of persons affected, one of them being attorneys. If it had been intended to hold an attorney personally liable for the acts of his clients, Congress would have so provided by apt language. That the statutory intent was to impose forfeiture only for the individual's own acts becomes even more clear when both sentences of section 249 are read together.

Petitioner's entire claim to *certiorari* against the respondent Miller is based on an attempt to broaden the application of section 249 of the Bankruptcy Act. That section is clearly a statute imposing a penalty. Consequently, it is elementary that it must be strictly construed. It certainly ought not, therefore, be held to impose vicariously upon individuals, liability for the acts of others, especially where its plain language is to the contrary.

The provision has been so construed. Thus in *In re Mortgage Guarantee Co.*, 40 Fed. Supp. 226, 237, 238, an attorney was awarded compensation by the court, although the very client for whom he appeared was denied com-

pensation by reason of transactions in the securities. In the case of *In re Midland United Co.,* 64 Fed. Supp. 399, aff'd. 159 F. 2d 340 (cited by petitioner) the chairman of a committee, one Lindley, was barred from recovering compensation because of his trading in the stock concerned, but neither the attorneys for the committee nor its other members were denied allowances. Similar cases are *In re Republic Gas Corp.,* 35 Fed. Supp. 300, and *In re Paramount Publix Corp.,* 12 Fed. Supp. 823, both cases cited by petitioner in the Court of Appeals. In both, individual committee members were denied compensation, on account of trading in the securities, but the other members of the committees who had not done so were compensated.

On this point the Court of Appeals in the instant case said:

> "The section does not expressly impute any fault to the attorney for his client's misconduct—assuming that that is not too strong a word. It only declares what his own disability shall be, if on his own account he buys and sells. To charge him with his client's dealings would compel him, at the risk of losing all his labor, either to keep an eye upon those dealings (which in practice would be so irritating as to imperil the continuance of their relations); or blindly to put any right to be paid at his client's mercy" (R. 763).

As specified in sections 241-244 of the Bankruptcy Act, allowances to attorneys in reorganization proceedings are made to them directly and not indirectly by way of an expense to the parties for whom they appeared, as was previously the practice in bankruptcy. The limitation of the requirement of section 249 with respect to forfeiture of an attorney's allowance only for his own personal trans-

actions and not for those of his clients is, therefore, consistent with the general provision of the law for compensation to attorneys.

The present law follows the equity rule, which, at least as far back as *Central Railroad* v. *Pettus,* 113 U. S. 116, 124-127, decided in 1885, permitted the attorney in a class action to apply directly for his fee. In fact, it seems to be implicit in that case that the attorney's right to an allowance does not necessarily depend upon whether or not the client could have claimed the amount as an expense in the first instance. It can readily be seen that the conduct of a stockholder or creditor who might have a minute interest in the result of a class action ought not to prejudice the right to recovery of an attorney whose services have resulted in obtaining a large fund for a class of many members, when the attorney himself has acted with complete propriety and diligence.

Petitioner nevertheless contends that the attorney's fee should be treated as though it were an expense of the party for whom he appeared and determined accordingly, citing *Young* v. *Potts,* 161 F. 2d 597, 600 and *Teasdale* v. *Sefton National Fibre Can Co.,* 85 F. 2d 379, 382. Neither case is in point. In *Young* v. *Potts,* the client, not the attorney, sought to be allowed an amount that he claimed he had actually expended for counsel fees. It was denied to him by reason of his own positive wrongdoing, pointed out by this Court in *Young* v. *Higbee Co.,* 324 U. S. 204, a prior decision in the same case. In the *Teasdale* case the court denied an allowance for the reason that it found that counsels' services had benefited only their own individual client and not the class as a whole. In the present case, of course, it is not even disputed, that Mr. Miller's efforts aided in establishing a very substantial fund for a definite class.

II

Not only is the attorney not held responsible for the activities of his clients under the provisions of section 249 of the Bankruptcy Act but, we submit, the activities of Mr. Miller's clients were not such as would have barred allowances, even to them, had they been the applicants instead of him.

The record is clear that three of Mr. Miller's clients did no buying or selling whatsoever (R. 155, 620, 621). Two did no buying during the period of the construction proceeding and sold no Fifth Series bonds, in which series alone Mr. Miller appeared, and such selling of other series as they did would come under the *de minimis* rule (*In re Midland United Co.*, 64 Fed. Supp. 399, 417) (R. 618, 619). One did not sell any of his Prudence bonds of any series. He did not buy any of the Fifth Series. (Bonds of that series which were transferred to him he either inherited or took as nominee of Adeson Corporation. He also inherited some bonds of other series.) There is no indication whatever that his acquisition of bonds of other series in addition to those he inherited either affected or were in any way affected by the litigation (R. 155, 708, 711).

Some of Mr. Miller's clients were connected with the securities business (R. 587), but there was no evidence justifying the term "speculators" with respect to them (petition, pp. 12, 20). In fact their transactions were quite obviously in the regular course of their business. That was their means of livelihood, just as sales of goods by a merchant are his. Trading by a broker in the regular course of his business is not the type of transaction proscribed by section 249 of the Bankruptcy Act (*In re Midland United Co.*, 64 Fed. Supp. 399, 417).

Mr. Miller's clients were neither trustees or agents of other bondholders nor did they constitute a committee. They were individual bondholders who intervened in the proceeding, being obliged to do so to protect their own interests as no one was doing it for them. They acted at their own risk and expense and, if their efforts had not resulted in establishing a fund for the benefit of the class, there would have been no obligation on the part of the others to assist them or to contribute to their expense.

The proceeding in which they intervened was not the reorganization proper. No plan was being considered, in which suggestions and objections would be offered, in which conferences and negotiations would be necessary and personal influences might tend to sway their acts. The "construction proceeding" was, as its name indicated, a purely legal proceeding brought for the interpretation of a plan long in effect. There were submitted for determination only questions of law. Neither Mr. Miller's actions nor the result of the litigation could have been influenced by any of his clients' transactions. The legal points he advocated were unaffected by extraneous considerations.

Even if Mr. Miller's allowance had depended on his clients' activities, it is clear that the latter do not come within the classes proscribed by section 249 of the Bankruptcy Act. His clients acted neither as fiduciaries nor as representatives of others. Several of them, furthermore, did no buying or selling whatever. Since those who did not buy or sell were not united in interest with those who did, there would have been no reason to deny them an allowance, had they themselves been the applicants, even though the attorney who represented them also represented the others. In Point I of this brief cases are cited where individual members of committees were denied compensation because of their transactions in the securities but in

those cases the other members of the committees and the attorneys were not affected. (See *In re Midland United Co.*, 64 Fed. Supp. 399, aff'd. 159 F. 2d 340; *In re Republic Gas Corp.*, 35 Fed. Supp. 300 and *In re Paramount Publix Corp.*, 12 Fed. Supp. 823.) The rule would appear to apply far more strongly in the case of individuals who did not even constitute a committee. Furthermore, even as to those who did buy and sell, as we have previously shown, their transactions also were not such as would have invoked the bar of section 249, had they been the sole applicants for the allowance.

Conceding that persons who, as individuals, prosecute a class action have an obligation to other members of the class, it cannot be held that their duty is coextensive with that of the trustee of an express trust or one who, by his status, assumes true fiduciary liability. This Court has recognized that there are varying degrees of fiduciary duty. (See *Manufacturers Trust Co.* v. *Becker*, 338 U. S. 304, 311, and *Securities and Exchange Commission* v. *Chenery Corporation*, 318 U. S. 80, 85, 86, 88, 89.)

The liability to other members of the class owed by individual litigants prosecuting a class action was considered by this Court in *Young* v. *Higbee Co.*, 324 U. S. 204. In that case parties had literally sold the cause of action of their class to its opponents for their own personal gain. This Court condemned them for so doing. It held that such individual litigants must refrain from deliberate injury to the class rights. That is, however, as far as this Court has extended the obligation of such individual litigants. Other cases on the general subject of the duties of fiduciaries, cited by petitioner, pertain either to trustees of express trusts or, at least, to persons standing in a higher degree of confidence than did Mr. Miller's individual clients.

It should be noted that petitioner in the construction proceeding took a position that Mr. Miller aptly termed "armed neutrality" (R. 331) as against the interests of the public bondholders of the Fifth Series advanced by Mr. Miller and other counsel for individual bondholders. The fact that the interests of such public bondholders were successfully defended against such covert opposition, as well as other active and strenuous opposition, is pragmatic proof in itself that Mr. Miller's clients did nothing to thwart the common cause of their class. The present opposition to his fee cannot, therefore, be based on any claim that either he or his clients were unfaithful to their obligation. The statute in question should therefore not be given a strained construction to accomplish an end opposed to the equities involved.

III

Petitioner contends that respondent Miller may not be awarded an allowance out of the fund of the class for the reason that he represented only the interests of his individual clients and was not bound to the class by fiduciary ties. Concededly, Mr. Miller appeared for his own clients, owners of Fifth Series bonds, in the construction proceeding involving that series. It was, however, impossible for him to advocate his clients' personal cause without at at the same time espousing the cause of their class as a whole. In fact, except for the appearance in the proceeding by counsel for individual bondholders acting on their own behalf, the interests of the class would not have been advocated by anyone. Certainly, therefore, the circumstance that Mr. Miller represented individual clients is not a basis for depriving him of a well earned fee out of the class fund.

Mr. Miller's position was, in fact, analogous to that of the attorneys whose claim to be paid out of a fund for the benefit of a class which their efforts had created was sustained by this Court in *Sprague* v. *Ticonic Bank,* 307 U. S. 161. In that case suit was brought on behalf of the settlor and beneficiary of a trust of which the bank was trustee to have the trust fund declared to be a preferred claim against the bank in receivership. The plaintiffs ultimately prevailed. Only by virtue of the rule of *stare decisis* and not by reason of independent suits by them, several other persons for whom the bank was also trustee under similar trusts, obtained the same preference as did the plaintiffs. The attorneys claimed compensation out of the entire fund which the receiver was obliged to segregate for the benefit of all of these preferred claims. Their right to be so compensated out of the entire fund was sustained by this Court.

Patently, the attorneys in that case owed no direct duty throughout the main litigation to any but the specific clients who had retained them. Likewise, Mr. Miller was not retained by all of the bondholders and, consequently, could press his contentions only on behalf of those who had. Nevertheless, while his direct obligation was to his own clients, all of the others benefited from his services and share equally in the fund thereby established. His right to compensation out of the fund therefore follows the principle of the *Sprague* case implicitly.

Petitioner cites *Dickinson Industrial Site Inc.* v. *Cowan,* 309 U. S. 382; *Brown* v. *Gerdes,* 321 U. S. 178 and *Young* v. *Higbee Co.,* 324 U. S. 204 as authority for his contention to the contrary. The first two cases did not concern the question here at issue and are not in point. In *Young* v. *Higbee Co.,* as we have previously stated, this Court held, merely, that individuals prosecuting a class action must act in good faith to the extent, at least, of refraining from

affirmative injury to the other members of the class. There is no claim that this respondent violated that requirement. Except for the actual wrongdoing there specified, the *Young* case does not preclude the right to an allowance out of a class fund to the attorney for individual litigants whose efforts have helped to create it, although of necessity his immediate retainer was by specific individuals.

IV

So far as the respondent Arthur Miller is concerned, no important question is presented requiring a review by this Court. As we have endeavored to show, on all of the facts in the record herein the allowance to him is amply justified by well established principles of law and equity. As applied to this case the meaning of section 249 of the Bankruptcy Act is entirely clear and the attempt to broaden its application to situations not therein contemplated is not a proper basis to request this Court's review.

The decision herein of the Court of Appeals does not conflict with that of any other circuit, nor with any of the other decided cases on the subject.

CONCLUSION

The petition for certiorari should be denied as to the respondent Arthur Miller.

Respectfully submitted,

ARTHUR MILLER,
Respondent, Pro Se

LESTER H. MARKS,
Counsel for respondent, Arthur Miller.

May 23, 1950.

APPENDIX

Bankruptcy Act, Sec. 241, 11 U. S. C. Sec. 641: The judge may allow reimbursement for proper costs and expenses incurred by the petitioning creditors and reasonable compensation for services rendered and reimbursement for proper costs and expenses incurred in a proceeding under this chapter—

(1) by a referee;

(2) by a special master;

(3) by the trustee and other officers, and the attorneys for any of them;

(4) by the attorney for the debtor; and

(5) by the attorney for the petitioning creditors.

Such compensation of referees and trustees shall not be governed by sections 40 and 48 of this Act.

Bankruptcy Act, Sec. 242, 11 U. S. C. Sec. 642: The judge may allow reasonable compensation for services rendered and reimbursement for proper costs and expenses incurred in connection with the administration of an estate in a proceeding under this chapter or in connection with a plan approved by the judge, whether or not accepted by creditors and stockholders or finally confirmed by the judge—

(1) by indenture trustees, depositaries, reorganization managers, and committees or representatives of creditors or stockholders;

(2) by any other parties in interest except the Securities and Exchange Commission; and

(3) by the attorneys or agents for any of the foregoing except the Securities and Exchange Commission.

Bankruptcy Act, Sec. 243, 11 U. S. C. Sec. 643: The judge may allow reasonable compensation for services rendered and reimbursement for proper costs and expenses incurred by creditors and stockholders, and the attorneys for any of them, in connection with the submission by them of suggestions for a plan or of proposals in the form of plans, or in connection with objections by them to the confirmation of a plan, or in connection with the administration of the estate. In fixing any such allowances, the judge shall give consideration only to the services which contributed to the plan confirmed or to the refusal of confirmation of a plan, or which were beneficial in the administration of the estate, and to the proper costs and expenses incidental thereto.

Bankruptcy Act, Sec. 244, 11 U. S. C. Sec. 644: Where a petition is filed under section 127 of this Act, the judge may allow, if not already allowed, reasonable compensation for services rendered and reimbursement for proper costs and expenses incurred in the pending bankruptcy proceeding—

(1) by a marshal, receiver, or trustee, as provided in subdivision g of section 48 of this Act, and the attorneys for any of them;

~~(2) by the attorney for the petitioning creditors;~~

(3) by the attorney for the bankrupt; and

(4) by any other persons and the attorneys for any of them entitled under this Act to compensation or reimbursement in such bankruptcy proceeding.

Bankruptcy Act, Sec. 249, 11 U. S. C. Sec. 649: Any persons seeking compensation for services rendered or reimbursement for costs and expenses incurred in a proceeding under this chapter shall file with the court a statement under oath showing the claims against, or stock of, the debtor, if any, in which a beneficial interest, direct or in-

direct, has been acquired or transferred by him or for his account, after the commencement of such proceeding. No compensation or reimbursement shall be allowed to any committee or attorney, or other person acting in the proceedings in a representative or fiduciary capacity, who at any time after assuming to act in such capacity has purchased or sold such claims or stock, or by whom or for whose account such claims or stock have, without the prior consent or subsequent approval of the judge, been otherwise acquired or transferred.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1949

No. [redacted] 52

PRUDENCE BONDS CORPORATION
(NEW CORPORATION),
Petitioner,

against

SAMUEL SILBIGER, *et al.*

MEMORANDUM FOR RESPONDENT SILBIGER ON PETITION FOR WRIT OF CERTIORARI

SAMUEL SILBIGER, *pro se.*
Attorney for Respondent.

SUPREME PRINTING CO., INC., 41 MURRAY STREET, N. Y., BARCLAY 7-0349

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1949

No. 785

PRUDENCE BONDS CORPORATION (NEW CORPORATION)
Petitioner,

against

SAMUEL SILBIGER, *et al.*

MEMORANDUM FOR RESPONDENT SILBIGER ON PETITION FOR WRIT OF CERTIORARI

Opinions Below

The opinion of the Court of Appeals for the Second Circuit dated March 7, 1950 (R. 755) is not yet reported. The opinion on the petitions for Rehearing, dated April 5, 1950 (R. 785) is not yet reported.

Jurisdiction

The decree of the Court of Appeals was entered on March 7, 1950 (R. 765). The decree denying rehearing was entered April 5, 1950 (R. 786).

Petitioner invokes the jurisdiction of this Court under Section 240 (a) of the Judicial Code, as amended, 28 U. S. C. 347 (a), and Section 24 (c) of the Bankruptcy Act, as amended, 11 U. S. C. Sec. 47 (c).

Petitioner's Questions

So far as the issues relating to respondent Silbiger is concerned, they may be summarized as follows:

On the premise that Silbiger represented conflicting interests and violated the "rule of undivided loyalty" as between attorney and client, did the Court below err in deciding that he was entitled to receive compensation for his services, and thus creating an exception to the general rule that in such circumstances an attorney is debarred from any fee whatever?

The Facts

For the determination of the limited issue presented, the petition sets forth the facts sufficiently except for two errors and one important omission. The statement on page 16 "But it is true that the subordinated bondholder did not speak for and was not authorized to speak for the Deficit Series public bondholders" is incorrect. Prudence Realization Corporation, the holder of the subordinated bonds, was likewise holder of unsubordinated bonds, in the same class as the public bondholders, aggregating $16,700 in the Third, Thirteenth and Fifteenth Series, which are "Deficit Series" (R. 672). The subsequent statement, on the same page, referring to the time the Court of Appeals rendered its decision, "Then for the first time the subordinated bondholders undertook to speak for the Deficit Series public bondholders," is likewise contrary to the fact.

There was involved in the "Construction Proceedings" the rights to distributive shares in sums aggregating $1,994,453.79 of collateral in the "Excess Series," A.A., 5th, 6th, 8th, 9th, 12th, 17th and 18th (R. 169). Of these sums the Special Master recommended and the District Court directed that $1,009,866.22 be paid to the subordinate bondholder Prudence Realization Corporation; $173,949.98 to

President and Directors of the Manhattan Co. for its liens in the 5th and 9th Series; and the balance of $810,637.59 to the public bondholders of the "Deficit Series" (R. 665). Prior to the arrival of the amount of excess of $360,610.22 in the Fifth Series the Special Master recommended the restoration of $81,565.14 from the principal to income account and its distribution to the public bondholders, of the Fifth Series. (Prior record 50, 57). Similarly in the Ninth Series, prior to his arrival at the excess of $463,285.24 the Special Master recommended the restoration of $46,631.51 from principal to income account and its distribution to the public bondholders of the Ninth Series (Prior record 547) and Prudence Realization Corporation filed exceptions thereto. (Prior record 88, 552). From the decrees of the District Court overruling such exceptions, Prudence Realization Corporation appealed. (Prior record 78, 557). If Prudence Realization Corporation was successful on its appeals the respective items $81,565.14 and $46,631.51 would have been added to the $810,637.59 claimed to be distributable to the public bondholders of the Deficit Series.

The important fact omitted from the petition herein is that Reconstruction Finance Corporation is a party to and appeared in the "Construction Proceeding". Through its wholly owned or controlled subsidiary corporations, it was the holder of a $1,000 bond in the 4th Series, the same series in which Katherine Born held bonds; $28,500 of bonds in the 11th Series, the same series in which Bessie B. Rielly held bonds; $20,400 in the 3rd series and $109,500 in the 13th Series, (R. 672) each of which was a deficit series.

Position of Respondent Silbiger

Respondent Silbiger on May 18th, 1950, herein filed a petition for a writ to review the decisions and decrees below, docketed as October Term, 1949, No. 829. It is his contention that the review of the decisions below should not

be limited or restricted as prayed by petitioner. The decision of the Court of Appeals, which reversed the finding of the Special Master and the District Court that respondent Silbiger "did not represent conflicting interests" is without warrant in fact or law.

The determination of respondent's right to compensation and its amount was not arrived at in the calm and judicial atmosphere that should pervade a Court of Justice. The trial of the issues deteriorated into a trial of respondent Silbiger's integrity as a member of the bar. The atmosphere was polluted with unwarranted charges of disloyalty and professional misconduct so as to deprive respondent of a fair trial of his just claims on the merits.

Respondent therefore respectfully prays that the petition herein be considered in conjunction with his petition filed May 18th, 1950 and that certiorari be granted to review all issues raised below on the merits.

Dated: May 19th, 1950.

SAMUEL SILBIGER, *pro se.*
Attorney for Respondent.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1949

No. [redacted] 52

PROTECTIVE-BONDS CORPORATION (NEW CORPORATION),
Petitioner,

against

SAMUEL SILBERMAN, et al.,

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR RESPONDENT WEIL, GOTSHAL & MANGES, IN OPPOSITION

WEIL, GOTSHAL & MANGES,
Respondent,
30 East 42nd Street,
New York City, N. Y.

FRANK L. WEIL,
EDWARD C. WALLACH,
MILTON HANDLOKER,
of Counsel.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1949

No. 785

PRUDENCE-BONDS CORPORATION (NEW CORPORATION),
Petitioner,

against

SAMUEL SILBIGER, et al.,

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR RESPONDENT WEIL, GOTSHAL & MANGES, IN OPPOSITION

Opinion Below

The opinion of the court of appeals for the second circuit is as yet unreported but appears at R. 755-787. The opinion of the district court appears at R. 318-322.

Jurisdiction

The decree of the circuit court of appeals was entered on March 7, 1950 (R. 765). Petitions for rehearing filed in that court were denied on April 5, 1950 (R. 786). The jurisdiction of this court is invoked under Section 240(a) of the Judicial Code, as amended, 28 U. S. C., Section 347(a) and Section 24(c) of the Bankruptcy Act, as amended, 11 U. S. C., Section 47(c).

Questions Presented

The questions presented, insofar as they affect respondent Weil, Gotshal & Manges, are:

(1) Assuming a client had two interests in conflict with each other, can an attorney, who was retained for and served only one of those interests, served that interest loyally and served no other interest, be held to have served conflicting interests so as to require the denial of compensation to him?

(2) Does the Bankruptcy Act require the denial of any allowance of compensation to an attorney whose client, without the knowledge of the attorney, purchased and sold securities of the corporation in reorganization?

Statute Involved

The Bankruptcy Act, as amended, provides in pertinent part:

SECTION 242 (11 U. S. C. Section 642). "The judge may allow reasonable compensation for services rendered and reimbursement for proper costs and expenses incurred in connection with the administration of an estate in a proceeding under this chapter * * *

* * * * *

"(2) by any other parties in interest * * *; and

"(3) by the attorneys * * * for any of the foregoing * * *."

SECTION 243 (11 U. S. C. Section 643). "The judge may allow reasonable compensation for services rendered and reimbursement for proper costs and expenses incurred by creditors * * * and the attorneys for any of them, * * * in connection with the administration of the estate. * * *."

SECTION 249 (11 U. S. C. Section 649). "* * * No compensation or reimbursement shall be allowed to any committee or attorney, or other person acting in the proceedings in a representative or fiduciary capacity, who at any time after assuming to act in such capacity has purchased or sold such claims or stock, or by whom or for whose account such claims or stock have, without the prior consent or subsequent approval of the judge, been otherwise acquired or transferred. * * *."

Statement

Respondent Weil, Gotshal & Manges has been awarded an allowance of $20,000 for its services in the "Construction Proceeding".[1] That proceeding was necessary in order to determine whether a "surplus", existing in the principal accounts of certain of the bond series, should be used to pay interest in full on the publicly held bonds of those "surplus" series in accordance with their original tenor, or should be allocated to the payment of subordinate bonds in the "surplus" series, and any balance remaining thereafter, prorated among the so-called "deficit series". Determination of this question meant a gain or loss to the public bondholders of the Fifth Series of $360,610.22, and a gain or loss to the public bondholders of all the "surplus" series of $1,994,453.79 (R. 168-169).

Until this problem arose, the public bondholders of all series (both "surplus" and "deficit" series) had no divergent interests. Accordingly, the New Corporation (the petitioner herein) was able to and did act on behalf of all series. However, when this problem of construction arose, the New Corporation took the position that it must remain neutral by reason of the divergent interests of "surplus" series on the one hand, and "deficit" series on the other (R. 288). It thus became necessary for those

[1] The petitioner has set forth a brief summary of the various proceedings in this Reorganization at pp. 4-9 of the petition. The details of the Construction Proceeding appear at pp. 6-9 of the petition.

bondholders who desired to protect their interests to intervene in the proceedings (R. 359).

Respondent Weil, Gotshal & Manges was retained by James L. White and several other public bondholders to intervene in the Fifth Series (a "surplus" series) in which they held bonds. This respondent thereupon took the position that the publicly held bonds in each series were entitled to be paid interest in full, in accordance with their original tenor, before there could be any surplus for distribution to subordinate bondholders in the particular "surplus" series, and "deficit" series bondholders thereafter (R. 260-264). The special master to whom the matter was referred took a contrary view in which position he was sustained by the district court. An appeal from the order of the district court was taken by this respondent Weil, Gotshal & Manges and by respondent Samuel Silbiger (R. 265). No other attorneys so undertook to protect the rights of the public bondholders of the "surplus" series. On appeal, the court of appeals for the second circuit reversed the district court and held that the publicly held bonds were entitled to full interest in accordance with their original tenor. At this point in the proceeding, the petitioner, who had asserted that it must remain neutral, joined in a petition to this court for the granting of a writ of certiorari. Again, only respondent Weil, Gotshal & Manges and respondent Silbiger defended the rights of public bondholders of the "surplus" series by opposing the granting of the writ. This court denied the petition.

Thereafter, the matter of the present allowances came on before the district court and was referred to a special master for the taking of testimony. At the hearings before the special master the following pertinent facts with respect to respondent Weil, Gotshal & Manges were disclosed and were in no respect disputed:

(1) Respondent Weil, Gotshal & Manges was retained and appeared in the Fifth Series only (R. 609-610, 353, 355, 571-572).

(2) Respondent Weil, Gotshal & Manges at all times advocated the claims only of the Fifth Series public bondholders (R. 351).

(3) Respondent Weil, Gotshal & Manges had no knowledge of its client's bond holdings in series other than the Fifth until immediately prior to the hearings on allowances (R. 570-571).

(4) Neither respondent Weil, Gotshal & Manges, nor any member of that firm, traded in the securities of the debtor corporation (Petition, p. 20).

(5) Respondent Weil, Gotshal & Manges had no knowledge that its clients had traded in the securities of the debtor corporation until immediately prior to the hearings on allowances (R. 570-571).

Argument

Petitioner claims that the allowance awarded to respondent Weil, Gotshal & Manges (and we here restrict ourselves solely to that respondent) is improper on two grounds, firstly, that this respondent served conflicting interests, and secondly, that Section 249 of the Bankruptcy Act requires the denial of any allowance to this respondent.

1. The Charge of Conflict of Interests

It is contended by the petitioner that, in view of the fact that the clients of respondent Weil, Gotshal & Manges owned bonds in both "surplus" and "deficit" series, these clients had conflicting interests; since respondent Weil, Gotshal & Manges served these clients, they necessarily served "conflicting" interests. Hence, it is claimed, under the doctrine of *Woods* v. *City National Bank & Trust Co.*, 312 U. S. 262, compensation should be denied this respondent.

This argument is utterly fallacious. True, the clients of this respondent held bonds in both "surplus" and "deficit" series. They chose to press the claims of one of these interests. Thus, it is undisputed that this respondent was retained by its clients to represent them as bondholders of the Fifth Series only, and instructed this respondent to take the position it did. Respondent represented bondholders of no other series. Moreover, petitioner concedes (Petition, p. 10) that Weil, Gotshal & Manges "confined their activities in the Construction Proceeding to the Fifth Series" and, again, that Weil, Gotshal & Manges "advocated in the Construction Proceeding the side of the surplus series" (Petition, p. 11). This respondent thus served the interests of their clients only insofar as they held bonds in the Fifth Series. (In fact, as appears above, this respondent knew of no other interests of their clients.) By so doing, it served the interests of all bondholders of the Fifth Series as well as all other "surplus" series. It did not "serve individual interests in conflict with the interests of the class" (public bondholders of "surplus" series) as petitioner claims (Petition, p. 21). On the contrary, the individual interests (i. e., Fifth Series interests) served by respondent Weil, Gotshal & Manges were identical with the interests of the class.

The fact that the clients held bonds in other series in no way affected the representation by Weil, Gotshal & Manges of their interests in the Fifth Series. Weil, Gotshal & Manges retained only in the Fifth Series, served one master only, a Fifth Series master and served that master consistently, undividedly, and well (R. 267). The propriety of this respondent's behavior, under these circumstances, cannot be questioned.

2. Client's Dealings in Securities of the Debtor

The second contention made by petitioner is that since the clients of respondent Weil, Gotshal & Manges traded in the securities of the debtor during the pendency of the proceeding, Weil, Gotshal & Manges should be denied compensation in accordance with Section 249 of the Bankruptcy Act.

This contention is equally without foundation. Section 249 denies compensation to

> "any committee or attorney, or other person acting in the proceeding in a representative or fiduciary capacity, who, at any time after assuming to act in such capacity, has purchased or sold such claims or stock, or by whom or for whose account such claims or stock have, without the prior consent or subsequent approval of the judge, been otherwise acquired or transferred."

Respondent Weil, Gotshal & Manges here seeks compensation in its own right by virtue of Sections 242-243 of the Bankruptcy Act. It is undisputed that neither respondent Weil, Gotshal & Manges, nor any member of that firm traded in the securities of the debtor (Petition, p. 20). Petitioner seeks to have compensation denied to said respondent on account of trading, unknown to respondent, by the clients.

Of course, any disability visited by Section 249 is a personal disability, extended only in rare instances to the trading of a wife or partner on the basis of the assumed benefit to the applicant. No case is cited by petitioner for the proposition that an attorney must be denied compensation on account of trading by his client. Moreover, in the case cited by petitioner to buttress its contention, the chairman of a committee was denied compensation for having himself traded in the securities of subsidiaries of the debtor corporation. Yet, this prevented neither

the remaining members of the committee nor the attorneys representing the committee from being awarded compensation. (*In re Midland United Company,* 64 F. Supp. 399, affd. 159 F. (2) 340.)

Again, in *In re Mortgage Guarantee Company* (40 F. Supp. 226, 237, 238), the disability of a client by virtue of Section 249 was specifically held not to extend to that client's attorney who was allowed compensation. This view of the statute is approved by leading authorities. Thus, it is stated in Collier on Bankruptcy, Vol. 6, 14th Edition, p. 4592:

> "The fact that a representative of creditors is barred from an allowance by virtue of § 249 will not prevent the making of an allowance to its counsel who has not participated in any transfers prohibited by the section, * * *."

We submit that the position advocated by the petitioner is clearly not the law. If, indeed, it were, it would only be in the rare situation that the interests of small creditors and minority groups would be protected in a situation such as arose in the instant case. Clearly, if attorneys had here known that they might be deprived of any allowance because, unknown to them, their clients held securities in other series or traded in securities of the debtor, they would have been extremely reluctant to embark on proceedings which have been as protracted as this proceeding.

The present Bankruptcy Act, and more particularly its revisions with respect to allowances, was intended to democratize reorganization proceedings by encouraging the participation of small creditors and minority groups. Such groups could rarely obtain representation if petitioner's contentions were sound. Obviously, small creditors could not undertake to compensate counsel fully for their services in complicated and protracted proceedings of this kind. Consequently, the Bankruptcy Act in order to assure such representation, provided for payment of attorneys' compensation out of the estate. But, if petitioner's position

is correct, the purpose of the latter provision would be nullified. Few attorneys would undertake such representation where an allowance was wholly dependent on the acts of a client beyond control of the attorney. As Judge Learned Hand said in the court below:

> "To charge him with his client's dealings would compel him, at the risk of losing all his labor, either to keep an eye upon those dealings (which in practice would be so irritating as to imperil the continuance of their relations); or blindly to put any right to be paid at his client's mercy."

Actually, mere "watching" of the client would be of no avail. No attorney could be expected to prevent a client from purchasing securities of the debtor where the client was determined so to do.

We submit that the petitioner's contentions find no support in either the applicable statutes or the pertinent decisions. Furthermore the acceptance of such contentions would lead to such absurd results as to demonstrate the complete fallaciousness of its position. For, if respondent Weil, Gotshal & Manges represented the entire class of publicly held bonds in all "surplus" series, as necessarily contended by petitioner, then said respondent would be debarred from any allowance if any of the thousands of public bondholders of the entire class traded in the bonds of any series or even owned a single bond in one of the "deficit" series.

Conclusion

This brief has been restricted to the questions presented insofar as they relate to respondent Weil, Gotshal & Manges. We respectfully submit that in view of the lack of conflict on these questions and in view of the fact that petitioner's contentions with respect to these questions raise no issues which require further review by this Court, certiorari should be denied in respect to respondent Weil, Gotshal & Manges.

WEIL, GOTSHAL & MANGES,
Respondent.

FRANK L. WEIL,
EDWARD C. WALLACE,
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May, 1950.